OFFICE OF THRIFT SUPERVISION

Business Transactions Division Memorandum:

Historical Framework for Regulation of Activities of Unitary Savings and Loan Holding Companies

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May 6, 1998

HISTORICAL FRAMEWORK FOR REGULATION OF ACTIVITIES OF UNITARY SAVINGS AND LOAN HOLDING COMPANIES

I. Introduction

The term "unitary savings and loan holding company" or "unitary thrift holding company" is a shorthand description of a corporate structure in which a company (or group of companies) controls a single savings association. The significance of this structure is that the holding company may engage in any legitimate business activity that it chooses; it is free from the activities restrictions that apply to bank holding companies.[1]

Why Congress has chosen, as it considers regulation of the holding companies of insured depository institutions, to treat unitary thrift holding companies differently from bank holding companies is the subject of this memorandum. The evolution of the unitary thrift holding company as a structure warranting different regulatory treatment reflects a number of changing public policy considerations that have been before Congress in the last thirty to forty years.

Initially, Congress was concerned with the perceived dangers presented by multiple holding companies, as opposed to unitary holding companies, even where the subsidiary was a bank. When Congress first enacted legislation in 1967 to regulate savings and loan holding companies, unitary or one-bank holding companies were exempt from the Bank Holding Company Act ("BHCA") and its restrictions on unrelated business activities. To qualify as a bank holding company at that time, a company had to control two or more banks. Partially in recognition that the BHCA restrictions applied only to multi-bank holding companies, Congress imposed activities restrictions only on multiple savings and loan holding companies.

Congress also recognized, however, the difference between, on the one hand, the traditional thrift focus on home mortgage lending and ancillary consumer services and, on the other hand, the commercial lending and more wide-ranging business-oriented services provided

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[1] This is, of course, changing. The Federal Reserve Board ("FRB") has permitted bank holding companies to engage in securities activities through so-called section 20 nonbank subsidiaries, although until recently such a subsidiary could earn only 10% of its total revenue from underwriting or dealing in securities ineligible for member bank investment ("bank-ineligible securities"). The FRB recently raised the revenue limit for such subsidiaries to 25% of bank-ineligible securities (61 Fed. Reg. 68750 (Dec. 30, 1996)), sparking a number of bank acquisitions of investment banking firms. Additionally, within the last year, the Office of the Comptroller of the Currency ("OCC") has indicated that a subsidiary of a national bank may be permitted to engage in non-banking activities. *See* 61 Fed. Reg. 60341 (Nov. 26, 1996).

by banks. In recent years, the major thrust of legislation has been aimed not at curbing the unrelated business activities of thrift holding companies, but rather at reinforcing the residential and consumer lending mission of their subsidiary associations. Congress first imposed a "qualified thrift lender test" ("QTL test") of "thriftness" on savings associations in 1987. Failure of a savings association to meet the QTL test can lead to substantial operational sanctions for a subsidiary thrift, and, more significantly, to required divestiture of non-banking business activities for the parent unitary holding company.[2] Two years later, Congress barred thrifts from making loans or extension of credit to affiliates engaged in non-banking activities.

The contemporaneous legislative history of the BHCA reflects different concerns. These have been framed as potential systemic threats presented by large one-bank and multi-bank holding companies that may form powerful banking/industrial conglomerates and possibly monopolize commercial credit. Congress has not historically expressed the same concern with respect to the interrelationship of activities of unitary savings and loan holding companies.

II. Comparison of Treatment of Business Activities of Unitary Savings and Loan Holding Companies and Bank Holding Companies

a. Bank Holding Company Background

Modern statutory regulation of bank holding companies at the national level began in 1956[3] when Congress identified two areas of concern about bank holding companies:

> (1) The unrestricted ability of a bank holding company group to add to the number of its banking units, made possible the concentration of commercial banking facilities in a particular area under a single control and management; and
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> (2) the combination under single control of both banking and nonbanking enterprises, departed from the principle that banking institutions should not engage in business wholly unrelated to banking.[4]

With regard to the first issue, the potential for the "monopolistic control of credit"[5] in

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[2] *See, e.g.*, 12 U.S.C. § 1467a(m)(3).

[3] Bank Holding Company Act of 1956, ch. 240, 70 Stat. 133 ("BHCA of 1956"). Ten years later, the BHCA of 1956 was modified by amendments generally unrelated to nonbanking activities. Act of July 1, 1966, Pub. L. No. 89-485, 80 Stat. 236 and 237 ("1966 BHCA Amendments").

[4] S. Rep. No. 1095, 84th Cong. at 2 (1955). Although the principle has been challenged of late, the Senate Committee then observed that the combination of banking and nonbanking enterprises under common control "constituted a departure from the established policy of separating banking from other commercial enterprises." *Id.*

[5] H.R. Rep. No. 609, 84th Cong. at 2 (1955).

different areas of the country, Congress directed the Federal Reserve Board to review bank acquisitions under several standards, including the possible effect on competition.[6] This approval process covered, however, only those acquirers that already owned at least one bank subsidiary.[7] The initial acquisition by a holding company entering the banking industry was not subject to this process, for several reasons. As the Senate Banking Committee later observed, unitary bank holding company operations in the mid-1950s were generally small and presented no serious supervisory problems.[8] Additionally, since banks were at the time subject to sometimes stringent state branching laws, a multiple holding company provided a possible vehicle for circumventing the laws.[9] Unitary holding companies could not, by definition, present such a risk. Congress also believed that blanket coverage by the BHCA would tend to discourage formation of new banks and force the sale of many existing banks.[10] This Congressional decision that only multiple bank holding companies were to be covered by the BHCA of 1956 was not modified by amendments to the BHCA in 1966.

As to the concern over the combination of banking and nonbanking activities under the holding company umbrella, i.e., the unrelated business activity issue, bank holding companies were generally prohibited, with certain limited exceptions, from owning shares in nonbanking companies. The major exception for nonbanking activities pertained to the acquisition of shares in "any company all the activities of which are of a financial, fiduciary, or insurance nature," which the FRB has found to be "so closely related to the business of banking . . . as to be a proper incident thereto."[11]

The latter provision, which governed the ability of bank holding companies to engage in otherwise nonexempt unrelated activities prior to the end of 1970, was strictly applied by the FRB. As a result, multiple bank holding companies were severely circumscribed in the types of nonbanking activities in which they could engage during that period. This limitation, however, did not apply to one-bank holding companies.

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6 Bank Holding Company Act of 1956, ch. 240, § 3(c), 70 Stat. 135.

7 *See* S. Rep. No. 1095, 84th Cong., at 5 (1955). "At that time only relatively small, rural and smalltown banks were exempted from bank holding company regulations by the so-called one-bank exemption." H.R. Rep. No. 91-387, at 2 (1969).

8 S. Rep. No. 91-1084, at 2 (1970).

9 H.R. Rep. No. 609, 84th Cong. at 3, 4 (1955).

10 *Id.*

11 Bank Holding Company Act of 1956, ch. 240, § 4(c)(6), 70 Stat. 137., Section 4(c)(6) was modified slightly by the 1966 BHCA Amendments and redesignated section 4(c)(8). Pub. L. No. 89-485, § 8(b), 80 Stat. 269 (1966). Of course, at that time (and through the present), there were statutory provisions outside the BHCA that affected a bank holding company's ability to engage in nonbanking financial activities. *See, e.g.*, section 20 of the Glass-Steagall Act (barring member bank affiliations with investment banking firms) (12 U.S.C. § 377).

b. Savings and Loan Holding Company Background

When savings and loan holding companies first came to the attention of Congress in the late 1950s, their numbers were few and opportunities for growth limited. The subsidiary thrift in a savings and loan holding company structure had to be in the stock form of ownership. Most of the nation's savings institutions were organized as mutuals, but all federally chartered associations, which constituted the majority of savings institutions, were required by statute to be mutuals. In contrast to their banking counterparts, savings and loan associations were basically restricted to local residential home mortgage lending and ancillary activities. Indeed, there were statutory restrictions on the geographic areas in which insured thrifts could make home mortgage loans and rates on deposit accounts were fixed by regulation.

Holding companies of state-chartered thrifts did exist, however, and there were no federal limitations on the nonthrift business activities in which they could be engaged. By the late 1950s, twenty states and Guam had laws permitting formation of stock savings and loan associations. Congress took notice of an "accelerating trend of acquisitions of stock savings and loan associations by savings and loan holding companies" and concluded that "stopgap legislation" was needed to arrest the probable acquisition of "most of the assets of the stock savings and loan institutions . . . [by] holding companies."[12]

From testimony at hearings in 1959, the Senate Banking Committee foresaw other potential problems if holding company acquisitions of thrift institutions were to continue unchecked. These concerns included monopoly and restraint of trade, financial manipulation and intercorporate dealings, and absentee ownership.[13] As a result of these findings, Congress imposed two significant restrictions on holding company control of thrifts in 1959. First, Congress essentially prohibited existing holding companies from acquiring any additional insured thrifts. Second, any other company was limited to the acquisition of one thrift. This temporary legislation, known as the Spence Act, did not prohibit or restrict the nonthrift-related business activities of existing savings and loan holding companies. The Federal Home Loan Bank Board ("FHLBB") was directed to make legislative recommendations to Congress on the overall regulation of savings and loan holding companies.[14]

Although the FHLBB submitted proposed statutory amendments as early as May 1960, it was not until 1967 that Congress took up the FHLBB's recommendations regarding the

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[12] S. Rep. No. 810, 86th Cong. (1959), *reprinted in* 1959 U.S.C.C.A.N. 2883.

[13] *See* S. Rep. No. 810, *reprinted in* 1959 U.S.C.C.A.N. 2887.

[14] *See* Pub. L. No. 86-374, 86th Cong., 73 Stat. 691-693 (1959). A year later, the Spence Act was made permanent. Pub. L. No. 86-746, 74 Stat. 83 (1960).

comprehensive regulation of savings and loan holding companies.[15] After lengthy hearings and debates, Congress eventually enacted the modern version of the Savings and Loan Holding Company Act ("SLHCA"),[16] which differed markedly from the FHLBB's recommendations with respect to the treatment of unrelated holding company business activities.

The FHLBB was primarily concerned with the supervisory problems raised where the holding company structure was employed to take advantage of subsidiary thrifts and divert their resources to non-thrift activities. Thus, the FHLBB recommended limiting all savings and loan holding companies -- unitary and non-unitary alike -- to five specific thrift-related activities, which, somewhat similar to the FRB's authority at the time, could be augmented by activities administratively found to be a "proper incident to the operation of insured institutions and not detrimental to savings account holders therein." Congress rejected this wholesale approach and confined these restrictions to multiple savings and loan companies only.[17] Because they were thereby entirely exempted from the activities restrictions imposed on multiples, unitary savings and loan holding companies were free to enter into any nonthrift business pursuit.

Congress's decision in 1967 to grant the nonthrift business exemption to unitaries was made purposefully and deliberately. As the Senate Report indicates, Congress sought to encourage the acquisition of single thrifts by companies outside the savings and loan business and to free such acquirers from the activities limitations applicable to multiple holding companies. Contrary to the Congressional attitude towards bank holding companies, there were no serious concerns over the combination of single thrift institutions and other commercial enterprises under common control. The Senate Report explains:

> There were arguments advanced that the definition of a holding company should be amended to apply only to those companies which control two or more associations. This would enable the owners of stock associations to sell the association to a corporate entity not in the savings and loan business.
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> The committee felt, however, that a complete exemption for all holding companies with one association would not provide the [FHLBB] with adequate supervisory authority. . .
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> In order to provide the [FHLBB] with adequate authority while at the same time alleviating the marketability problem for existing stock associations, the committee recommended that holding companies which control only one

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[15] S. 1542 and H.R. 8696, 90th Cong. (1967).

[16] Savings and Loan Holding Company Amendments of 1967, Pub. L. No. 90-255, 82 Stat. 5 (1968).

[17] *See* Pub. L. No. 90-255, 82 Stat. 8 (1968).

> association be exempt only from the unrelated activities and divestment provisions of section 408(c). This would permit the sale of a stock association to a corporation (provided the corporation controlled no other associations) but at the same time will provide the [FHLBB] with the examination, registration, and reporting authority it needs. . .
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> In adopting such an amendment, the committee also recommends that the [FHLBB] approve, under statutory standards, all sales of savings and loan associations to companies not in the savings and loan business. This will insure that the assets of an association will not be jeopardized by transferring control of the association to interests inimical to the financial integrity of the association.[18]

c. Extension of BHCA of 1956 to One-Bank Holding Companies

In the years immediately after enactment of the 1966 BHCA Amendments, the composition of one-bank holding companies changed drastically. Twenty-three of the 51 banks in the United States with deposits of $1 billion or more, including the six largest in the country, holding over 20 percent of the deposits of the entire banking system, became subsidiaries of one-bank holding companies by 1970.[19] Although no major abuses relating to one-bank holding companies were then detected, Congress determined to address possible future problems posed by the one-bank holding company device:

> In view of the large growth of the assets held by the one-bank holding company industry, and in view of the theoretical freedom of a one-bank holding company to engage in any business, or acquire anything it desires (subject to antitrust laws), the committee is agreed that it is necessary to amend the Bank Holding Company Act to bring one-bank holding companies under the regulation provided by that act.[20]

Accordingly Congress enacted the Bank Holding Company Act Amendments of 1970,[21] a fairly comprehensive revision of the 1956 BHCA that formed the nucleus of the modern version of the BHCA. As the quoted passage suggests, one of the major concerns raised by the growth of one-bank holding companies was their entrance into nonbanking businesses, which contravened the prevailing belief that banking should remain separate from commerce. Many one-bank holding companies engaged in commercial or industrial pursuits that had no

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[18] S. Rep. No. 354, 90th Cong. 6, 7 (1967) (emphasis added).

[19] S. Rep. No. 91-1084, at 3 (1970). "It has been estimated that the percentage of the Nation's total banking deposits which are held by banks controlled by one-bank holding companies has grown from less than 10 percent in early 1967 to more than 40 percent at the present time." *Id.*

[20] S. Rep. No. 91-1084, at 3, 4 (1970).

[21] Pub. L. No. 91-607, 84 Stat. 1760 (1970) ("BHCA Amendments of 1970").

discernible relation to their banking powers. These businesses included television broadcasting, the manufacture of furniture, yarns, carpets, lawnmowers, and shoes, and the operation of department stores, experimental farms, ranches, pizza parlors, and restaurants. The mixture of these operations with commercial banking, was, in the view of the chairman of the House committee, "clearly against the public interest."[22]

Partly in response to the extension of bank holding company regulation to one-bank holding companies and the unexpected development in the unrelated activities of one-bank holding companies, and to add interpretive flexibility (as suggested by the Federal Reserve Board and other Federal regulators), Congress retained the "closely related/proper incident" standards of section 4(c)(8) of the BHCA but added a balancing test that read as follows:

> In determining whether a particular activity is a proper incident to banking or managing or controlling banks the [FRB] shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.[23]

Subsequent FRB application of the revised test in section 4(c)(8) of the BHCA, combined with strict BHCA grandfather rules, generally forced the large one-bank holding companies formed in the late 1960's to divest their nonbanking activities. Despite extensive later amendments to section 4(c)(8) designed primarily to curb bank holding company encroachment into the insurance business and to expedite resolution of the thrift crisis of the late 1980's, the approval standards of section 4(c)(8) have remained unchanged since the BHCA Amendments of 1970.

As a rule, the FRB has not attempted to expand the section 4(c)(8) rules in approving new nonbanking activities for bank holding companies. The FRB's rules regarding bank holding companies are contained in its Regulation Y.[24] In its latest revision to Regulation Y, effective April 21, 1997, the FRB codified a list of fourteen categories of previously approved, permissible nonbanking activities.[25] Various FRB rulings on provisions of the BHCA, including interpretations regarding activities determined closely related to banking can also be found in other provisions in Regulation Y.[26] Regulation Y also contains a list of seven

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[22] H.R. Rep. No. 91-387, at 27-30 (1969). (Individual views of Chairman Patman).

[23] 12 U.S.C. § 1843(c)(8) (West Supp. 1997); *see* S. Rep. No. 91-1084, at 12-16 (1970).

[24] 12 C.F.R. Part 225.

[25] 62 Fed. Reg. 9335-38 (Feb. 28, 1997) (to be codified at 12 C.F.R. § 225.28).

[26] *See* 12 C.F.R. §§ 225.101-145 (1996).

activities that the FRB has determined are not closely related to banking.[27] There is, of course, nothing in the FRB's regulatory scheme comparable to the unlimited range of nonthrift activities open to properly conducted unitary thrift holding company operations.

d. Post-1968 Developments Affecting the Unrelated Business Activities of Unitary Thrift Holding Companies

The statutory exemption for the unrelated activities of unitary thrift holding companies remained unaffected for fifteen years following its adoption in 1968. During this period, holding company formations accelerated as conversions of associations from the mutual to stock form gradually increased, aided by the ability of Federal associations for the first time to convert to the stock form without relinquishing their Federal charters.[28] With the enactment of the Garn-St Germain Depository Institutions Act of 1982 ("DIA"),[29] the FHLBB was granted the authority to issue de novo Federal stock charters. Thereafter, the stock charter became the preferred form of organization in the savings and loan business and the use of the unitary holding company format grew accordingly.

The DIA, however, also imposed the first statutory condition on unitary thrift holding companies' exemption from unrelated business activities. Where a subsidiary savings association failed to qualify as a domestic building and loan association under the Internal Revenue Code, after a period of three years for compliance, its parent holding company and any of the parent's nonthrift subsidiaries were limited to the activities permitted for multiple holding companies.[30]

Five years later the enactment of the Competitive Equality Banking Act of 1987 ("CEBA")[31] brought the QTL test, a measure of an association's "thriftness." The QTL test is keyed to a percentage of a subsidiary thrift's assets devoted to "qualified thrift investments" ("QTI"). This test performed the same function as the DIA's requirement of qualification as a domestic building and loan association. That is, the subsidiary thrift of a unitary holding

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[27] 12 C.F.R § 225.126 (1996) The list covers (a) insurance premium funding; (b) underwriting life insurance not sold in connection with a credit transaction; (c) real estate brokerage; (d) land development; (e) real estate syndication; (f) management consulting (*but see* new 12 C.F.R § 225.28(b)(9)); and (g) property management.

[28] Pub. L. 93-100, § 4, 87 Stat. 343 (1973) (adding new subsection (j) to section 403 of the National Housing Act ("NHA") (12 U.S.C. § 1725) providing for approval of a small number of study conversion applications) and Pub. L. No 93-495, Title I, § 105(d), 88 Stat. 1504 (1974) (adding paragraphs 3-6 to subsection (j) of section 403 of the NHA to provide broader approval authority).

[29] Pub. L. No. 97-320, 96 Stat. 1469 (1982).

[30] Pub. L. No. 97-320, § 335, 96 Stat. 1505 (1982).

[31] Pub. L. 100-86, 101 Stat. 552 (1987).

company was required to meet the test; otherwise, the holding company would be treated essentially as a bank holding company. Under the CEBA QTL test, QTI are defined generally to include residential real estate loans and other housing related investments.[32] Largely prompted by the rapid expansion in powers of both state and federally chartered savings institutions in the early 1980s, the QTL test was intended partially to complement companion CEBA provisions aimed at closing the so-called "nonbank bank" loophole in the BHCA.[33]

The QTL test was further refined by the Financial Institutions Reform, Recovery and Enforcement Act of 1989, ("FIRREA"),[34] which also moved the statutory location of the SLHCA from Title IV of the NHA, major portions of which were repealed, into a new Section 10 of the Home Owners' Loan Act ("HOLA").[35] Without discussing the intricacies of the QTL

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[32] *See* Pub. L. 100-86, § 104(c), 101 Stat. 571 (1987). The general rule was that to satisfy QTL 65% of a savings association's assets needed to come within the definition of QTI. Congress expanded the definition of QTI in 1996 as part of the Economic Growth and Paperwork Reduction Act. Under the amendment, credit card, educational, and small business loans were included in QTI. *See* Pub. L. No. 104-208, § 2303(g), 110 Stat. 3009-425 (1996) (codified at 12 U.S.C. § 1467a(m)(4)(C)(ii)(VII)).

[33] *See* S. Rep. No. 100-19, at 13-15 (1987). The Senate Report described the nonbank bank loophole as follows:

> The nonbank bank loophole arises from the definition of a bank in the Bank Holding Company Act. Under that Act, a bank is defined as an institution that accepts demand deposits and makes commercial loans. A bank that refrains from one of those two activities is not considered a bank for purposes of the Bank Holding Company Act; hence the term nonbank bank.
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> Although nonbank banks continue to be regulated as banks--by the Comptroller of the Currency in the case of national banks and by the State bank supervisors in the case of State-chartered banks--they are exempt from two key provisions of the Bank Holding Company Act. Those are the interstate restrictions in section 3 and the activities restrictions in section 4.
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> The impetus for nonbank banks stems primarily from large diversified companies wanting to invade the banking business while avoiding the regulatory restraints of the Bank Holding Company Act. Thus some of the nation's largest retailing, securities, and insurance companies have been able to enter the banking business through the nonbank loophole while banks are prevented from entering those businesses by the Bank Holding Company Act.
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> *Id.* at 5, 6 (emphasis in original).

[34] Pub. L. 101-73 (August 9, 1989).

[35] 12 U.S.C. § 1467a *et seq.* Amendments to the HOLA in 1996 broadened the coverage of QTI to include loans for educational purposes, loans to small businesses, and credit card loans. Pub. L. 104-208, § 2303, 110

test, it is sufficient to observe that the penalty imposed on a unitary thrift holding company for the failure of the QTL test by its subsidiary association is mandatory registration and treatment of the parent company as a bank holding company, beginning one year after the failure.[36] For many unitaries, the confinement of their unrelated business activities to those permissible for bank holding companies could have a disastrous impact by causing the forced sale of either the subsidiary thrift or other profitable entities.

Although the effect of a subsidiary thrift's failure of the QTL test on a parent unitary holding company can be quite severe, one significant conclusion can be inferred from requiring compliance with the QTL test. Implicit in the QTL test is a Congressional determination that ownership of a single savings association by a firm engaged in commercial activities does not raise the types of concerns regarding the mixture of banking and commerce and the monopolization, or discriminatory availability, of commercial credit that led to enactment of the BHCA of 1956 and its extension to one-bank holding companies by the BHCA Amendments of 1970.

Recent OTS reports to Congress suggest that the unitary thrift holding company structure has encouraged notable but not overwhelming investment by non-banking firms in home mortgage and consumer lending.[37] Of a total of over 600 unitary holding companies as of June 30, 1977, only 102 unitary companies were actively engaged in nonbanking activities, and these companies together owned 64 thrifts. The range of nonbanking activities by these unitary holding companies varies. Several, but fewer than half, of the 102 companies engage in financial activities such as insurance sales and underwriting, investments, mutual fund management and investor services, and broker-dealer operations.[38] A greater number of unitary holding companies have affiliates that do business in non-financial areas, predominantly real estate and related services. Other non-financial activities of these unitary companies include management services, hotel operations and development, and wood products. In surveying many of these holding companies, OTS discovered that the subsidiary thrift contributes either a minimal amount to holding company revenue (less than 10% in 41% of the cases) or significant amount (over 50% in 56% of the companies surveyed).[39] As these figures show, the OTS experience with holding companies engaged in non-banking activities has been modest. Since the enactment of the savings and loan reform legislation in 1989 and the creation of OTS, unitary thrift holding companies have not as a class presented special

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Stat. 3009-425 (1996).

[36] *See* 12 U.S.C. § 1467a(m)(3)(C).

[37] *See* Holding Companies in the Thrift Industry – Background Paper (April 1997); Holding Companies in the Thrift Industry – Supplement to April 1997 Background Paper (January 1998).

[38] *See* Supplemental January 1998 Paper at 25.

[39] *See id.* at 21.

supervisory problems.[40]

III. Non-Activity Restraints on Unitary Holding Companies

Although unitary savings and loan holding companies may engage freely in a variety of commercial and financial activities, they do not enjoy free rein to operate the subsidiary savings association solely to maximize the value of the holding company structure. Both Congress and OTS have imposed a variety of requirements, in addition to the QTL test, on unitary (and multiple) holding companies that are designed to protect the safety and soundness of the subsidiary thrift and to enable the subsidiary thrift to perform its core functions.

The existence of a holding company structure presents two kinds of risk for the subsidiary savings association: (i) that the holding company may require the subsidiary to make excessive dividend payments or other transfers; and (ii), less directly, that the holding company may direct the subsidiary to conduct operations in a way that destabilizes the thrift or otherwise detracts from the thrift's lending and other business operations. The restrictions on unitary holding companies cover both kinds of risk.

First, several statutory and regulatory provisions prevent a holding company from directly undermining the capital position of the subsidiary thrift. The thrift itself is subject to capital requirements that OTS has developed (with the other banking agencies) under the so-called "prompt corrective action" provisions of the Federal Deposit Insurance Act.[41] As a general rule, the subsidiary must maintain a total risk-based capital ratio of 8% and Tier 1 risk-based capital and leverage ratios of 4% to remain adequately capitalized.[42] If capital drops below that level, then the holding company must guarantee the thrift's compliance with a capital restoration plan and provide adequate assurances of performance by the thrift.[43] If the holding company fails to provide the appropriate guarantee and assurances of performance, OTS may, among other things, require the holding company to divest itself of the thrift or of certain affiliates that present significant risks to the thrift.[44]

Buttressing this basic requirement of adequate capitalization is the OTS capital distribution rule. This rule, which pre-dates the prompt corrective action provisions, requires

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[40] *See id.* at 3-6 (discussing examinations, enforcement actions, and thrift failures); 9-18 (comparisons of thrift subsidiaries of unitary companies with other thrifts).

[41] *See* 12 U.S.C. § 1831o.

[42] *See* 12 U.S.C. § 12 C.F.R. § 565.4(b)(2). In some cases, the leverage ratio may drop to 3% without affecting the thrift's adequately capitalized status.

[43] *See* 12 U.S.C. § 1831o(e)(2)(C); 12 C.F.R. § 565.5(b).

[44] *See* 12 U.S.C. § 1831o(f)(2)(I)(ii), (iii).

OTS approval of any dividend that would cause a thrift to fall below any of its capital requirements.[45] Dividends that would not have cause a capital failure are also subject to limitations based on the thrift's net income.[46] Further, tax sharing agreements between a thrift and its holding companies must conform with several OTS guidelines designed to ensure that the thrift bears its proporational tax liability but not that of the holding company or affiliates.[47]

Second, indirect means by which a holding company might unduly exploit the subsidiary thrift are subject to intensive regulation:

- *Transactions with affiliates*. All thrifts must observe the percentage limitations and arms' length dealing requirements applicable to member banks on transactions with affiliates under sections 23A and 23B of the Federal Reserve Act.[48] Among other things, a thrift's total covered transactions with any one affiliate may not exceed 10% of the thrift's capital stock and surplus, and total covered transactions with all affiliates may not exceed 20% of capital stock and surplus.[49] Such covered transactions must be on terms comparable to those of transactions between non-affiliated entities.[50]

- *No loans to non-banking affiliates*. Section 11(a)(1)(A) of the HOLA prohibits entirely loans or other extensions of credit by a thrift to any affiliates that are engaged in activities that are not permissible for a bank holding company.[51] This prohibition prevents a unitary thrift holding company from using the thrift to fund non-banking activities and enhances the parity between bank and thrift holding companies on transactions with affiliates.

- *Loans to one borrower*. Thrifts are subject to essentially the same limitations as national banks on loans to one borrower, which includes loans to a holding company.[52]

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[45] *See* 12 C.F.R. § 563.134(b)(3).

[46] *See* 12 C.F.R. § 563.134(b)(1).

[47] *See* OTS Regulatory Handbook: Holding Companies § 500, at 88-90 (1993). Unsecured advance tax payments by the thrift to the holding company would be considered unsecured advances in violation of 12 C.F.R. § 563.41(c).

[48] *See* 12 U.S.C. § 1468(a).

[49] 12 U.S.C. § 371-c; *see* 12 C.F.R. § 563.41 (1997).

[50] 12 U.S.C. § 371c-1; *see* 12 C.F.R. § 563.42 (1997).

[51] *See* 12 U.S.C. § 1468(a)(1)(A).

[52] *See* 12 U.S.C. § 1464(u).

This limitation is 15% of unimpaired capital,[53] which, depending on the circumstances, may be more or less restrictive than the transactions-with-affiliates restrictions discussed above.

- *Anti-tying restrictions*. These restrictions are designed to prevent a holding company from compelling or inducing a customer from doing business solely with the holding company and its subsidiaries by linking products or services of the thrift and an affiliate.[54]

- *Prohibition of evasion of restraints on subsidiary thrifts*. Section 10 of the HOLA prohibits a holding company from undertaking an activity for the purpose of evading the restraints on the activities of the subsidiary thrift.[55]

- *Sales of securities*. Among the abuses of the 1980s was the sale of holding company securities on the premises of the subsidiary thrift. Customers unwittingly transferred amounts from insured deposits to these uninsured investments. OTS has since prohibited these on-premises sales.[56]

- *Serious risk*. The Director of OTS has the authority to impose certain restrictions on a holding company or any of its subsidiaries, if there is reasonable cause to believe that an activity by the holding company or a subsidiary constitutes a serious risk to the financial safety, soundness, or stability of a subsidiary thrift.[57] The Director may restrict dividend payments by the thrift, limit the thrift's transactions with the holding company or affiliate that presents the risk, or restrict any activity of the thrift that might create a serious risk that the liabilities of the holding company and its other affiliates may be imposed on the thrift.[58] The Director also may order termination of the affiliate's activity or divestiture of the affiliate, after notice and opportunity for hearing.[59]

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53 *See* 12 U.S.C. § 84.

54 *See* 12 U.S.C. § 1464(q).

55 *See* 12 U.S.C. § 1467a(c)(1)(A).

56 *See* 12 C.F.R. § 563.76.

57 *See* 12 U.S.C. § 1467a(p)(1).

58 *See id.*

59 *See* 12 U.S.C. § 1467a(g)(5).

IV. Conclusion

Over the past thirty years, the unitary savings and loan holding company structure has served as a vehicle for companies not otherwise engaged in the banking business to establish a financial subsidiary that serves the needs of individual consumers. From the perspective of the thrift, the unitary structure has offered the ability to tap expanded sources of capital. When Congress has expressed concern about possible risks presented by the unitary holding company structure, it has enacted requirements that are appropriately tailored to the public policy at issue. For example, in 1987 Congress sought to ensure that the benefits of unitary status would be available only to those companies that owned institutions that focused on home mortgage lending and accordingly established the qualified thrift lender test. Congress since has expanded the test to include consumer, educational and some small business lending but continues to exclude from unitary status those holding companies that present the perceived risks that the mixing of banking and commerce may create. The 1989 savings and loan reform legislation contained substantial new requirements for the thrift industry in order to prevent a recurrence of the crisis of the mid- and late 1980s. Among the new provisions were enhanced provisions on transactions with affiliates, loans to one borrower, and tying arrangements as well as stronger authority for OTS to take appropriate regulatory or enforcement action against holding companies. OTS' experience with holding companies since that time has been modest, and the thrift industry (as well as the banking industry) has enjoyed unparalleled prosperity. The evidence of the last several years is that the unitary thrift holding company has been one way in which Congress has allowed the provision of financial services to evolve, free from undue government restriction but subject to limitations that protect consumers, depositors, and the insurance fund.